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| INQUIRY INTO MATTERS CONCERNING INTERCARRIER COMPENSATION | ) ) ) | UTILITY DIVISION<br>DOCKET NO. D2004.5.84 |

**Verizon's Opening Comments on the Missoula Plan**

Verizon, which includes the former MCI companies operating in Montana and Verizon Wireless (collectively, "Verizon"), submits these comments for consideration by the Commission on the Missoula Plan. Verizon offers these comments in response to the Commission's Notice of Inquiry and Notice of Public Workshop issued in this docket on August 18, 2006.

As explained below, while the Missoula Plan (or the "Plan") has some positive aspects, such as some unification of rates and rate structures, its flaws far outweigh these few benefits and are too numerous and substantial for it to be implemented by the FCC. The Plan is unduly complex, would be extremely costly to implement, is disproportionately favorable to rural carriers at the expense of other carriers, and either fails to address, or exacerbates, some of the main challenges of the existing intercarrier compensation regime. Moreover, there is no reason to believe that the current version of the Missoula Plan will serve in any way as the basis for FCC resolution of its intercarrier compensation docket. Indeed, the Missoula Plan is only one of several proposals that have been filed in that docket, and it lacks industry consensus.

## 1. THE MISSOULA PLAN DOES NOT ACCOMPLISH THE GOALS THAT INTERCARRER COMPENSATION REFORM SHOULD ACCOMPLISH

In its NPRM,[1] the FCC identified a number of goals for intercarrier compensation reform, including the simplification of existing regimes, closing loopholes and unifying rates to minimize arbitrage opportunities, and lowering some of the highest access rates. The FCC further stated that it was most interested in promoting economic efficiency through competitively and technologically neutral rules, decreasing the need for regulatory intervention, and solving current arbitrage problems.[2] As described below,[3] the Missoula Plan meets none of these objectives, and in some cases would make achieving them far more difficult.

In light of the FCC's stated goals, Verizon has identified a set of five principles that should govern any reform of existing intercarrier compensation regimes.[4] In significant respects, the Missoula Plan is inconsistent with these principles.

*First*, any attempt at intercarrier compensation reform must account for the fact – already reflected in market-based arrangements – that interconnection in some cases does not always benefit both networks equally. Today's marketplace provides numerous examples of different networks interconnecting on commercially negotiated terms in the absence not only of any regulation of the rates on which they exchange traffic, but also in the absence of any regulatory mandate to interconnect in the first place. The Internet is a prime example. What is commonly referred to as "the Internet" in fact consists of a series of individual networks, owned and operated by a variety of private entities that have entered into purely voluntary interconnection arrangements. Another example is direct interconnection between wireless networks, which

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1 *In the Matter of Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, FCC 05-33, Further Notice of Proposed Rulemaking (released March 3, 2005) ("Intercarrier NPRM").

2 *Id* at ¶¶ 29-36.

3 *See infra* pp. 6-12

4 *See generally* Verizon's comments, filed in CC Docket No. 01-92, May 23, 2005, at 3-5.

occurs not because of any regulatory mandate, but because large traffic volumes, a relative balance of traffic, and equal bargaining power justify such arrangements.

Carriers make different decisions on whether to undertake the significant investment required to build and improve networks. As a result, although interconnection may result in an equal exchange of value in some cases, in other cases interconnection may provide greater benefits to one of the interconnecting carriers – typically the carrier that has chosen not to invest in network infrastructure. Commercially negotiated agreements in the context of the Internet recognize this fact, as companies agree to forgo intercarrier compensation when they believe interconnection provides roughly equal value to each, but insist on some form of compensation when that is not the case. An approach that does not recognize this reality would drastically cut incentives for carriers to build and improve network infrastructure because network builders would not be able to recover the value created by those investments; at the same time, non-network providers would have increased incentives to free ride on the investments of the network builders.

The Missoula Plan creates a disincentive to network investment by ignoring existing network and related infrastructure and assuming that all participants are working from an imaginary "clean slate" that supposes no existing network investment. For example, the Plan adopts default rules that would force interconnection at "Track 1" carriers' (all regional Bell operating companies ("RBOCs") and "other non-rural carriers") access tandems, even though today traffic is efficiently routed to both local and access tandems of "Track 1" carriers. The Plan would also require every carrier, including wireless carriers, to permit direct connection at an "Edge,"[5] regardless of the fact that there are more efficient indirect connection arrangements currently in place. The Plan would thus require massive network architecture changes with little

[5] An Edge refers to the location on a carrier's network where it receives traffic for routing within its network and where it performs the termination function for traffic received from other carriers. *See* Plan at 42.

benefit. The Plan would also offer many carriers little choice but to make extensive changes to billing systems and to record billing on trunks that are today not recorded. Intercarrier compensation should reduce the transaction costs associated with interconnection, not increase them. Implementing the Plan's provisions for network interconnection, transport, passing of call information (to address the issue of phantom traffic), and billing would require significant investment by carriers. And this substantial investment would be mandated at the same time that current technology is increasingly being displaced by more efficient Internet Protocol ("IP") networks.

*Second*, any reform plan should preserve existing negotiated arrangements and facilitate additional ones. In particular, any new approach should not interfere with the commercially negotiated arrangements that exist between carriers. Nor should reform apply default rules where networks exchange packets on an IP basis without using the circuit-switched network – regardless of whether the packets are carrying voice, data, or video, and regardless of the carrier involved. Moreover, any new regime should encourage carriers exchanging circuit-switched wireline and wireless traffic to make investment and interconnection decisions driven by economics rather than regulatory gamesmanship. Accordingly, a reform plan should not establish default rules that, in practice, will replace economic behavior with actions based on an artificial regulatory regime.

The Missoula Plan directly contradicts this preservation principle by overriding many existing market-based arrangements. For example, the Plan would supersede existing contractual arrangements that are in "evergreen" periods, *i.e.*, in cases where the initial term of the agreement has lapsed. The Plan would also only protect existing arrangements where there is specific language in the contract mandating that it does so, which is inconsistent with the "change of law" provisions contained in most agreements in place today. In fact, the Plan would gut most of the interconnection arrangements Verizon companies maintain today with other carriers. The only interconnection agreements that the Plan would leave intact are those that both explicitly reject agreement changes based on changes in law and are not in evergreen status.[6] Virtually none of Verizon's agreements would qualify because they provide that a change in law either automatically modifies the agreement or requires the parties to renegotiate.

In the interest of unification, the Missoula plan would force changes in existing arrangements that would be harmful. For example, many of the minutes Verizon exchanges with other incumbent local exchange carriers ("ILECs") today are handled on a "bill-and-keep" basis under various EAS arrangements. The Missoula plan would override those agreements for Track 2 carriers ("most mid-sized rural carriers"), and would give Track 3 carriers ("rural rate of return regulated carriers") an incentive not to renew them, because the default rules would allow those carriers to charge interstate access rates for that traffic. The result would be that compensation would actually increase for a large category of traffic, and EAS arrangements that have benefited consumers would be threatened.

*Third*, any reform plan should provide for a more uniform rate structure for various types of traffic than exists currently. The desirability of this feature follows from the first two principles. Greater rate uniformity for various types of traffic reduces opportunities for carriers to benefit from non-compliance with the rules. The Missoula Plan espouses, but contravenes, this principle by maintaining separate rate levels and structures for different types of carriers. By doing so, it leaves the door open for existing arbitrage opportunities, and creates new ones by making states' reform of intrastate access rates optional. A major aspect of this problem is that the Plan fails to unify rates and rate structures for "Track 3" carriers.

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6 *See* Plan at 4.

*Fourth*, any reform plan should provide sufficient flexibility to ensure that carriers can recover the costs currently recovered through intercarrier compensation and can be compensated for the value provided by interconnection with other networks. Intercarrier compensation reform provides the opportunity to promote competition and eliminate regulatory arbitrage. While the Missoula Plan seeks to preserve carrier revenues through the Restructure Mechanism, the Plan does not explain how it will be funded. Moreover, as with other elements of the Plan, the Restructure Mechanism is too heavily weighted in favor of perpetuating the massive subsidy flows from other carriers to the rural local exchange carriers ("RLECs").

*Fifth*, a reform plan should avoid disruptive changes to existing interconnection architectures. Carriers have been interconnecting their networks for nearly a decade under the rules implementing the 1996 Act – and for much longer for interLATA and wireless traffic. After considerable litigation about the requirements of the 1996 Act, as implemented through FCC and state commission rules, most of those requirements are now settled and have been internalized – and built into physical network architecture – by market participants. Adoption of a new set of interconnection rules would serve primarily to upset settled expectations and potentially strand massive investments. For example, the plan would move the "Edge" of Track 1 carriers from the end office to the access tandem. This would create a new incentive for those carriers who have already established direct trunking to end offices, or to local tandems, to drop those trunks, and to route their traffic instead through the tandem. Carriers adapting to those rules, while transitioning to a new intercarrier compensation regime, will face significant costs that will likely outweigh any benefits. Moreover, the rules will inevitably create yet another set of arbitrage opportunities.

## 2. THE MISSOULA PLAN IS EXCESSIVELY COMPLEX AND COSTLY AND FAILS TO RESOLVE SOME OF THE MOST VEXING PROBLEMS WITH THE EXISTING INTERCARRIER COMPENSATION REGIME

There is no "one-size–fits-all" approach to resolving the myriad issues involved in intercarrier compensation reform. Since the passage of the 1996 Act, this Commission (and others) and carriers of every stripe have expended significant resources litigating arbitrage schemes that arose from the first well-intentioned regulatory compensation regime. There is no certainty that the next well-intentioned regulatory compensation regime will be any more successful in avoiding non-economic results and arbitrage opportunities that are inherent in any set of complex regulatory mandates. The Missoula Plan is unduly complex: one hundred and ninety three pages of new default rules, and interconnection terms and conditions that would maintain a system of multiple varying rates for different classes of carriers. The Plan establishes different rules for three separate categories of carriers, Track 1 (all RBOCs and "other non-rural carriers"), Track 2 ("most mid-sized rural carriers") and Track 3 ("rural rate of return regulated carriers" or "rural ILECs"). The Plan establishes a series of option elections that could potentially drive further disparities among carriers, even those within the same Track. The Plan relies upon voluntary participation by the states in reducing intrastate originating access rates.[7] Because some states may choose not to participate in the Plan, some intrastate originating rates would be outside of the Plan and inconsistent with Plan rates, undermining the goal of uniformity for all affected carriers. To the extent reform is meant to simplify existing rules, this plan fails to do so.

In addition, the Plan would not resolve some of the most challenging problems with the existing intercarrier compensation regime. For example, the Plan permits Track 3 carriers (rural ILECs) to continue to distinguish between, and charge varying rates for access and reciprocal

[7] Executive Summary at 2.

compensation traffic. This perpetuates the incentive to disguise the jurisdictional nature of traffic in order to game the system and invites even more carrier efforts to generate new arbitrage schemes.

In fact, the Plan could make an existing arbitrage opportunity relating to ISP traffic even worse. Instead of keeping the current ISP rule, the Plan modifies the existing approach: if traffic is out of balance beyond the 3:1 ratio, the recipient still gets paid the same terminating rate as for any other traffic – but must pay 100% of the transport between the two carriers. Thus, the Plan would create a new incentive, albeit one that is the polar opposite of the one created under the existing regime: under Missoula, carriers would attempt to shift their transport costs onto receiving carriers by focusing not on serving customers with only inbound calling (e.g., ISPs), but rather those customers with only outbound calling, like call centers.

In addition, the Plan also would exacerbate rather than resolve the disputes surrounding the Major Trading Area ("MTA") rule. By relying upon telephone numbers to determine jurisdiction instead of the end points of a call, roaming traffic that is properly considered subject to reciprocal compensation will instead be subject to access charges, even when the calling and called party are right around the corner from each other. The Plan would undermine settled federal court decisions finding that all traffic exchanged between LECs and CMRS providers is subject to reciprocal compensation regardless of whether it is carried by an IXC. Moreover, it would further condition the ability of wireless carriers to collect reciprocal compensation for traffic originated by LECs.

Finally, the Plan fails to bring down the highest access rates, another major problem with the existing regime. The interstate access rates that the Plan reduces the fastest are those for the Track 1 carriers, rates that were the lowest to begin with and have dropped even further over the last few years. At the same time, however, the Plan does not affect the interstate rates for Track

3 carriers, rates that are five times higher than the rates of the Track 1 carriers, and in some cases are rising rather than falling.[8]

By imposing a patchwork of rules applicable to different carriers, the Plan's complexity fails to meet a fundamental goal of intercarrier compensation reform. By failing to reduce the highest access rates, the Plan fails to meet a critical challenge of the existing environment. In sum, the Missoula Plan is, at best, a seriously flawed start to a still-evolving process.

## 3. THE MISSOULA PLAN IS NOT COMPETITIVELY NEUTRAL

The Plan unduly favors rural ILECs (or "RLECs"),[9] by protecting their existing access charges and, by so doing, protecting them from the financial effects of competition. That, in turn, undercuts the incentive for CLECs and other carriers to bring choice and competition to rural areas because they would have to compete with highly subsidized service rates. There is no longer a reason for the government to protect rural carriers from the competition that is ubiquitous everywhere else in the telecommunications market.

First, the Plan leaves RLECs' interstate rates, the highest interstate rates being charged, untouched. If states opt out of participating in the Plan, then the RLECs' high originating intrastate access rates will remain high as well. In fact, in that case the only reductions the RLECs would face under the Plan would be for their terminating intrastate access rates, which would be reduced to interstate levels.

Second, under the Rural Transport Rule,[10] the RLECs benefit from a highly favorable and inequitable transport regime. Today, RLECs often get other carriers to pay 50% of the transport to and from the RLEC switch. Under the Plan, other carriers would be required to pay an even

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8 As Verizon recently made clear in a filing with the FCC, rural carriers who are part of the NECA pool are earning in excess of their authorized rate of return and rather than reducing switched access rates, the NECA pool carriers are seeking to increase their switched access rates by approximately 6 percent. *See* Petition of Verizon, WCB/Pricing File No. 06-15, Transmittal No. 1129, dated June 23, 2006, at 2-3.

9 Not surprisingly, members of the Rural Alliance make up the overwhelming majority of the Plan's proponents.

10 *See* Plan at 30-34.

higher percentage of the RLECs' transport costs, in some cases even bearing 100% of transport costs in both directions. While there are two transport options, both end up with other carriers paying at least 75% of the RLEC's transport cost.

Third, the Plan contains a Restructure Mechanism that disproportionately favors RLECs. The theory behind the Restructure Mechanism ("RM") is that carriers will recover for access charge reductions through the RM. In order to implement the RM, carriers would determine RM payments through three calculations: (i) identification of revenue loss based on the reduced access rates; (ii) imposition of increases in the subscriber line charge ("SLC") to new capped levels as identified in the Plan and (iii)) recovery through the RM of whatever part of the lost revenues that cannot be recovered through SLC increases. If a carrier chooses not to increase the SLCs to the maximum extent possible described in (ii), that foregone revenue cannot be recovered from the RM.

But these recovery rules are stacked to benefit the RLECs in two important ways. First, the new SLC cap differs for the three Tracks. The Plan calls for Track 1 carriers, who operate in the most competitive markets (and thus are least able to increase SLCs), to increase the SLC to $10 (with increases for inflation). For these carriers, most of the revenue forgone through reductions in access charges would be recovered through SLC increases, rather than from the RM. But because the SLC increases are unlikely to be sustainable in the markets Track 1 carriers serve, the Plan does not provide those carriers with a reasonable opportunity for recovery. By contrast, Track 3 carriers, who compete in the least competitive markets, only have to raise their SLCs to $8.75, with no inflation adjustment. Most of their recovery will come from the RM, rather than from their own end users. In effect, RLEC customers will contribute less "self-help" in the form of end-user rate increases, and Verizon's customers will then be asked to make up the resulting shortfall through contributions to the RM.

Second, even if a Track 1 carrier can qualify for the RM, its compensable loss due to the Plan (and its SLC increases) is calculated on a per line basis – which means that any recovery does not compensate Track 1 carriers for line loss. Carriers in Tracks 2 and 3, on the other hand, are compensated both for losses due to lower access rates and losses due to line loss. As a result, the RLECs would receive a substantially disproportionate amount of cost recovery from the RM.

**4. THE MISSOULA PLAN LEAVES A NUMBER OF QUESTIONS UNANSWERED**

Although it is promoted as being "comprehensive," the Plan leaves important issues unaddressed. For example, the Plan does not explain how the RM would be funded —or even whether it will constitute "universal service" funding. And while it does address VoIP to PSTN traffic, the Plan does not address PSTN to VoIP traffic, which is likely to be growing just as fast over the next few years.

Perhaps most important among the unanswered questions, the Plan does not address state preemption issues. Instead, the Plan sidesteps preemption, presuming instead that the FCC can garner the necessary legislative affirmation of the Plan's provisions wherever necessary.[11] To be effective, however, new intercarrier compensation rules must apply at both the interstate and intrastate levels. Many of the concerns regarding the current regulatory scheme – and some of the primary opportunities for arbitrage – are rooted in the efforts by some carriers to exploit the disparity between the interstate rates regulated by the FCC and the intrastate and local rates currently regulated by state commissions. A Plan with voluntary state participation invites a continuation of such disparities and the arbitrage they drive. Full analysis of the Plan's potential outcomes is impossible without more definitive information on how many states might opt out.

In short, the Missoula Plan, while an ambitious undertaking, is too complex, too costly to implement, leaves open or creates too many arbitrage opportunities, is far too generous to rural

[11] *See* Executive Summary at 3.

carriers at the expense of the rest of the industry, and leaves too many important questions unanswered for the Commission to rely upon it in Montana.

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MARK STAPLES
Montana Counsel for Verizon